# Management's Discussion and Analysis

during 2007 was due to the growth in the liability for claims unpaid as a result of the Medicare line of business, as described in line 1 above.

Line 4 – Aggregate Health Policy Reserves – As of December 31, 2007 and 2006, WHP reported aggregate health policy reserves of $948,440 and $1,020,757, respectively. As part of the Medicare Part D program, CMS shares the risk with all Part D health plans for a certain portion of their enrollees' drug costs. Using a complex formula based on a health plan's annual bids and actual costs, financial targets are calculated for each plan and the health plan's actual costs are then compared to the targets in an annual reconciliation process. If actual costs are above the target, the health plan is generally owed additional amounts from CMS or if those costs are below the targets, the plan must repay a portion of the savings to CMS. For the years ended December 31, 2007 and 2006, WHP's actual costs were below the calculated targets so the plan owed additional amounts to CMS. The 2006 amounts were settled during the third quarter of 2007 and the 2007 amount is an estimate of amounts due based on the application of the CMS formula on 2007 claims.

Line 8 – Premiums Received in Advance – At December 31, 2007 and 2006, WHP reported $305,858 and $0 of premiums received in advance, respectively. The 2007 amount is comprised of payments received by WHP from CMS that were then determined to be owed back as a result of retroactive member terminations. These amounts were recovered by CMS through the normal monthly payment adjustment process in January 2008.

Line 9 - General expenses due or accrued – As of December 31, 2007 and 2006, WHP had amounts accrued of $326,301 and $202,135, respectively. The balance consisted of $111,000 of accruals for professional tax and audit services for 2007 as well as combined amounts due of $215,301 for trade payables, provider chart review fees, pharmacy administrative costs, network access fees and December 2007 reinsurance premiums. At December 31, 2006, all amounts due consisted of accruals for professional tax and audit services.

Line 15 – Amounts due to parent, subsidiaries and affiliates – At December 31, 2007 and 2006, WHP reported $0 and $938,492, respectively. For 2006, this amount consisted of underpaid management fees to Windsor Management Services, Inc. WHP's sister corporation. This underpayment was the result of an underestimate in the monthly payment.

Line 20 – Liability for Amounts Held Under Uninsured Plans – At December 31, 2007 and 2006, WHP reported $5,259,566 and $5,579,245, respectively. Under the Medicare Part D low income subsidy program, certain individuals may qualify for financial assistance in paying for their prescription drugs. The health plans in turn have no financial risk for certain prescription drug costs incurred by these individuals. During the annual bidding process, each health plan provides CMS with estimates of costs that will be incurred by these qualifying individuals and plans are then paid on a prospective basis each month based on actual enrollment. At the end of each calendar year, a reconciliation is performed to compare the total prospective payments for a calendar year to the actual expenses incurred for that same period. In both 2006 and 2007, the reconciliation resulted in a net overpayment to WHP, and accordingly, these amounts were owed back to CMS. The 2006 liability was recovered by CMS in the third quarter of 2007 and it is expected the 2007 settlement will occur in the third quarter of 2008.

**(iii) Capital and Surplus**

Line 24 – WHP's Common Capital Stock remained unchanged at $100,000 in 2007 and 2006.

Line 26 – At December 31, 2007 and 2006, WHP had $83,890,279 and $85,190,279, respectively, of Gross Paid In and Contributed Surplus. The change in Gross Paid In and Contributed Surplus is related to a dividend paid to WHG in the amount of $1,300,000. WHP has not had any capital contributions since 2000, when the corporate structure of WHP and its affiliated entities changed.

Line 27 – At December 31, 2007 and 2006, WHP had a subordinated note due to Vanderbilt University in the amount of $4,231,300. This note was approved by the Tennessee Department of Commerce & Insurance on March 30, 2001. Any interest expense related to this note has been accrued and reported in compliance with the NAIC and Tennessee guidelines. For statutory

purposes, interest expense has only been recorded through June 2002 as no interest expense or payments have been approved since that time. In January 2007, the Tennessee Department of Commerce & Insurance approved an interest payment request in the amount of $50,109 for the period of April - June 2002. As of December 31, 2007 and 2006, interest of $1,413,718 and $1,130,742, respectively (for the periods of July 2002 through December 2006 and December 2007) has not been paid (or reported as expense, in accordance with statutory guidelines). WHP is not in default of any of the note terms as of December 31, 2007 or 2006.

Line 28 – As of December 31, 2007 and 2006, there were 100,000 shares of $1.00 par value common stock issued and outstanding. The maximum amount of dividends that can be paid to shareholders, with the prior approval of the Tennessee Commissioner of Insurance, is limited to the greater of 10% of net worth as of December 31 next preceding or the net income from operations (excluding realized capital gains) for the twelve-month period ending December 31 next preceding. In December 2007, WHP provided notification to the Department of its intention to pay a dividend to its parent, WHG, in the amount of $1,300,000. This dividend has been recorded in the December 31, 2007 financial statements.

Net Worth Overall – At December 31, 2007 and 2006, WHP had statutory net worth of $8,284,598 and $6,618,137, respectively. For both years, net worth includes the subordinated note of $4,231,300. For 2007, WHP had excess net worth of $1,993,289 over the minimum requirement of $6,291,309. For 2006, WHP had excess net worth of $2,445,916 over the minimum requirement of $4,172,221.

## B. RESULTS OF OPERATIONS

Member Months: WHP had 189,478 total member months for 2007 as opposed to 55,671 total member months for 2006. At December 31, 2007, WHP had approximately 10,300 members enrolled in its MA-PD plan and 8,300 members in its PDP plan. In comparison, at December 31, 2006, WHP had approximately 4,900 members enrolled in its MA-PD plan. In accordance with NAIC guidelines, membership related to WHP's TennCare ASO line of business has not been reflected for 2007. On the statements for 2006, WHP incorrectly reported the TennCare membership in its member months. WHP gains membership in all of its Medicare plans through direct sales by employed agents and outside brokers as well as through the CMS auto assignment process on the PDP plan.

In June 2006 the State of Tennessee made the decision to change the administration of the TennCare program in the Mid Cumberland region of Tennessee. This change was effected through an RFP process with the end result being the selection of two managed care organizations to administer the TennCare program in the aforementioned region effective April 1, 2007. Although WHP submitted a proposal, the contracts were awarded to two other MCO's. As a result, the ASO agreement between WHP and the State of Tennessee Bureau of TennCare ended effective April 1, 2007. WHP was subsequently required to sign a contract amendment effective through December 31, 2007 to provide run-out services for claims incurred prior to April 1, 2007. WHP did not receive any additional administrative fees for providing these nine months of additional services.

Line 2 – At December 31, 2007 and 2006, WHP reported premium revenue of $119,328,295 and $57,048,413, respectively. This increase in premium can be attributed to WHP's expansion of the Medicare line of business. In 2007, WHP expanded its MA-PD service area to 31 counties in the states of Tennessee, Arkansas and Mississippi compared to only seven Tennessee counties in 2006. Effective January 1, 2007, WHP also became licensed by CMS to offer stand alone prescription drug plans ("PDP") in the CMS regions of Tennessee/Alabama, Arkansas and Mississippi and private fee for service ("PFFS") plans in the state of Tennessee. All premium revenue for 2007 is related to the Medicare line of business, as there are no premiums in the TennCare line of business.

Lines 9-16 – WHP reported total medical expenses for 2007 and 2006 of $93,706,916 and $45,655,995, respectively. The significant change from 2006 to 2007 is a result of the growth in the Medicare line of business.

## Management's Discussion and Analysis

Line 17 – At December 31, 2007 and 2006, WHP reported net reinsurance recoveries of $461,000 and $0, respectively. See Line 14 on the Assets page for further explanation.

Line 20 – At December 31, 2007 and 2006, WHP reported claims adjustment expense of $94,964 and $81,205, respectively. As with the liability explained previously, these expenses are a direct result of the Medicare operations and the increase in the claims unpaid liability.

Line 21 – General Administrative Expenses include all direct expenses incurred by the health plan (accounting, actuarial, and auditing fees) as well as management fees charged by Windsor Management Services, Inc., WHP's sister corporation that manages the day-to-day operations of the health plan. Management fees for both lines of business are assumed to include expenses such as salaries and general operating "overhead." WHP itself does not have any employees. Management fees are paid to WMS on a monthly basis pursuant to the agreements.

For the Medicare line of business, management fees are stipulated to be 14% of premium revenue per the management fee contract. Prior to the termination of WHP's participation in the TennCare program on April 1, 2007, WHP received a monthly administrative fee for providing services under the ASO arrangement. In general, there was a large discrepancy between the administrative fee revenue actually received by WHP each month and the related management fee expense resulting from the stipulated management contract calculation. At the sole discretion of the WMS Board of Directors, a portion of the contractually stipulated management fees for the TennCare line of business was forgiven for certain periods. In general, when it was determined that an amount would be forgiven for a particular year, it was calculated to be the difference in total administrative fees paid to WHP by the State of Tennessee and the management fee calculation per the management contract (implied premium revenue x 11.5% less the subordinated note interest expense). For 2007, there were no TennCare management fee amounts forgiven by the WMS Board of Directors. For 2006, $3,171,120 of calculated TennCare management fees were forgiven through a WMS Board of Directors resolution.

In accordance with NAIC guidelines, on the supporting schedules of the NAIC filing, the management fees have been allocated to the appropriate expense categories as if they had been incurred directly by the plan. The method of allocation used is described in the Notes to Financial Statements.

Line 27: Net Investment Gains (Losses) consists of interest recorded in the period in which it is earned from investments in an overnight sweep account and other instruments used by WHP, as discussed in the assets section above, less any interest expense. In 2007, WHP recorded $1,293,658 of investment income that was offset by $69,816 of amortization expense related to WHP's pledged investments and $50,109 of interest expense. In 2006, WHP recorded $600,869 of investment income that was offset by $75,544 of amortization expenses related to WHP's pledged investments.

## C. CASH FLOW AND LIQUIDITY

WHP did not receive any contributions to capital in 2007 or 2006. WHP believes that its current capital combined with anticipated continuing growth will be sufficient to allow the plan to meet all statutory requirements and outstanding obligations into the immediate future.

## D. OTHER ITEMS

In August 2006, WHP changed its legal name from Windsor Health Plan of TN, Inc. to Windsor Health Plan, Inc. dba VHP CommunityCare. WHP continued to conduct all TennCare business in the VHP name, except on documents and other items where the legal name was required.

In August 2005, WHP received its contract from the Centers for Medicare and Medicaid Services (CMS) to become a Medicare Advantage/Medicare Advantage Prescription Drug (MA-PD) plan beginning January 2006. For 2006, WHP offered its MA-PD products to beneficiaries in seven Tennessee counties. Effective January 1, 2007, WHP was approved by CMS to offer its MA-PD products in 26 additional counties in the states of Tennessee, Arkansas and Mississippi. Effective January 1, 2007 WHP also was approved to offer two new products including a stand

# Management's Discussion and Analysis

alone Prescription Drug Plan (PDP) in the states of Alabama, Arkansas, Mississippi and Tennessee and a Private Fee For Service (PFFS) in the state of Tennessee.

In June 2006, the state of Tennessee solicited requests for proposals from all managed care organizations interested in contracting to provide coverage for all TennCare beneficiaries throughout the middle Tennessee grand region. The intention and result of this RFP process was the selection of only two managed care organizations to provide all TennCare services for this region effective April 1, 2007. WHP submitted an RFP but was not one of the final two organizations selected. As a result, WHP ceased coverage of all TennCare beneficiaries effective April 1, 2007.

In February 2008, the Department approved a request to pay Vanderbilt University $1,253,740 of interest on the subordinated surplus note for the periods of July 2002 through June 2007. This expense will be reflected in the 2008 statutory financial statements.

# Windsor Health Plan, Inc.

Statutory-Basis Financial Statements and
Supplemental and Additional Information
as of and for the Years Ended
December 31, 2007 and 2006, and
Independent Auditors' Report

## WINDSOR HEALTH PLAN, INC.

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Windsor Health Plan, Inc.
Brentwood, Tennessee

We have audited the accompanying statutory-basis statements of admitted assets, liabilities, capital and surplus of Windsor Health Plan, Inc. (the "Company") as of December 31, 2007 and 2006, and the related statutory-basis statements of revenues and expenses, changes in capital and surplus, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in Note 2 to the financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the Tennessee Department of Commerce and Insurance, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, such statutory-basis financial statements present fairly, in all material respects, the admitted assets, liabilities, and capital and surplus of Windsor Health Plan, Inc. as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 2.

Our 2007 audit was conducted for the purpose of forming an opinion on the basic 2007 statutory-basis financial statements taken as a whole. The supplemental schedule of investment risk interrogatories and the supplemental summary investment schedule as of December 31, 2007 are presented for purposes of additional analysis and are not a required part of the basic 2007 statutory-basis financial statements. The additional information on the summarized schedule of revenues and expenses of the Company's TennCare operations is presented for the purpose of additional analysis and is not a required part of the basic financial statements, but is required by the Tennessee Department of Commerce and Insurance. Such additional information is not intended to present the results of TennCare operations of the Company.

These schedules are the responsibility of the Company's management. Such schedules have been subjected to the auditing procedures applied in our audit of the basic 2007 statutory-basis financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the basic 2007 statutory-basis financial statements taken as a whole.

This report is intended solely for the information and use of the board of directors and the management of Windsor Health Plan, Inc. and for filing with state insurance departments to whose jurisdiction the Company is subject and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

April 30, 2008

## WINDSOR HEALTH PLAN, INC.

**STATEMENTS OF ADMITTED ASSETS, LIABILITIES, CAPITAL AND SURPLUS — STATUTORY BASIS AS OF DECEMBER 31, 2007 AND 2006**

| | 2007 | 2006 |
|---|---|---|
| **ADMITTED ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 19,913,524 | $ 14,221,064 |
| Premiums receivable | 2,842,874 | 2,921,416 |
| Accounts receivable from State of Tennessee - net | 800,480 | 567,655 |
| Other receivables | 514,247 | 486,890 |
| Investment income receivable | 96,279 | 73,860 |
| Deferred tax asset | 260,594 | - |
| Total current assets | 24,427,998 | 18,270,885 |
| RESTRICTED INVESTMENTS - At amortized cost | 5,829,237 | 5,046,487 |
| TOTAL | $ 30,257,235 | $ 23,317,372 |
| **LIABILITIES, CAPITAL, AND SURPLUS** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable and accrued expenses | $ 319,907 | $ 202,135 |
| Medical costs payable | 15,128,565 | 8,958,606 |
| Payable to Centers for Medicare and Medicaid Services | 948,440 | 1,020,757 |
| Funds held for the benefit of members | 5,259,566 | 5,579,243 |
| Due to related party | 694,800 | 938,492 |
| Total current liabilities | 22,351,278 | 16,699,233 |
| COMMITMENTS AND CONTINGENCIES | | |
| CAPITAL AND SURPLUS: | | |
| Common stock, $1 par value - 100,000 shares authorized, issued, and outstanding | 100,000 | 100,000 |
| Paid-in and contributed surplus | 83,890,279 | 85,190,279 |
| Unassigned deficit | (80,315,622) | (82,903,440) |
| Surplus note payable | 4,231,300 | 4,231,300 |
| Total capital and surplus | 7,905,957 | 6,618,139 |
| TOTAL | $ 30,257,235 | $ 23,317,372 |

See notes to statutory-basis financial statements.

## WINDSOR HEALTH PLAN, INC.

### STATEMENTS OF REVENUES AND EXPENSES — STATUTORY BASIS
### FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

| | 2007 | 2006 |
|---|---|---|
| REVENUES: | | |
| Premium revenue | $ 119,984,167 | $57,048,413 |
| Recovery of medical expense | 10,764 | 5,009 |
| Investment income - net | 1,223,843 | 525,325 |
| Total revenues | 121,218,774 | 57,578,747 |
| EXPENSES: | | |
| Medical costs | 94,148,540 | 45,661,004 |
| Administrative services expense - net | 2,113,121 | 1,299,381 |
| General and administrative expenses | 20,346,899 | 9,276,180 |
| Interest expense | 50,109 | - |
| Total expenses | 116,658,669 | 56,236,565 |
| NET INCOME BEFORE TAXES | 4,560,105 | 1,342,182 |
| PROVISION FOR INCOME TAXES | 1,596,037 | - |
| NET INCOME | $ 2,964,068 | $ 1,342,182 |

See notes to statutory-basis financial statements.

## WINDSOR HEALTH PLAN OF TN, INC.

### STATEMENTS OF CHANGES IN CAPITAL AND SURPLUS — STATUTORY BASIS
### FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

| | Common Stock | Paid-In and Contributed Surplus | Unassigned Deficit | Surplus Note Payable | Total Capital and Surplus |
|---|---|---|---|---|---|
| BALANCE — January 1, 2006 | $ 100,000 | $ 85,190,279 | $ (84,233,122) | $ 4,231,300 | $ 5,288,457 |
| Change in non-admitted assets | - | - | (12,500) | - | (12,500) |
| Net income | - | - | 1,342,182 | - | 1,342,182 |
| BALANCE — December 31, 2006 | 100,000 | 85,190,279 | (82,903,440) | 4,231,300 | 6,618,139 |
| Change in non-admitted assets | - | - | (636,844) | - | (636,844) |
| Change in net deferred income taxes | - | - | 260,594 | - | 260,594 |
| Dividend to Windsor Health Group, Inc. | - | (1,300,000) | - | - | (1,300,000) |
| Net income | - | - | 2,964,068 | - | 2,964,068 |
| BALANCE — December 31, 2007 | $ 100,000 | $ 83,890,279 | $ (80,315,622) | $ 4,231,300 | $ 7,905,957 |

## WINDSOR HEALTH PLAN, INC.

### STATEMENTS OF CASH FLOWS — STATUTORY BASIS
### FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

| | 2007 | 2006 |
|---|---|---|
| CASH FLOWS FROM OPERATIONS: | | |
| Collection of premiums | $ 119,990,392 | $ 54,994,885 |
| Net investment income | 1,271,210 | 559,315 |
| Payment of interest on surplus note | (50,109) | - |
| Payments to providers and the State of Tennessee | (88,621,126) | (37,176,787) |
| Payments of general and administrative expenses | (22,513,562) | (9,788,016) |
| Deficiency of administrative services fees received net of general and administrative expenses paid | (1,912,132) | 122,039 |
| Net cash from operations | 8,164,673 | 8,711,436 |
| CASH FLOWS FROM INVESTMENTS: | | |
| Purchase of investments | (2,792,536) | (3,088,850) |
| Maturities of investments | 1,940,000 | 770,000 |
| Net cash for investments | (852,536) | (2,318,850) |
| CASH FLOWS FROM FINANCING AND MISCELLANEOUS SOURCES: | | |
| Dividend paid to parent | (1,300,000) | - |
| Funds received for the benefit of members - net | (319,677) | 5,579,243 |
| Net cash (for) from financing and miscellaneous sources | (1,619,677) | 5,579,243 |
| RECONCILIATION OF CASH AND CASH EQUIVALENTS: | | |
| Net change in cash and cash equivalents | 5,692,460 | 11,971,829 |
| Cash and cash equivalents - beginning of year | 14,221,064 | 2,249,235 |
| Cash and cash equivalents - end of year | $ 19,913,524 | $ 14,221,064 |

See notes to statutory-basis financial statements.

## 1. ORGANIZATION

Windsor Health Plan, Inc. (the "Company"), is a health maintenance organization ("HMO") that provides managed care services to government-sponsored healthcare programs. The Company is a wholly-owned subsidiary of Windsor Health Group, Inc. ("Windsor"). Effective January 1, 2006, the Company contracted with the Centers for Medicare and Medicaid Services ("CMS") to begin operating Medicare Advantage Prescription Drug ("MA-PD") plans in three regions within the state of Tennessee. As a contracted managed care organization ("MCO") in the State of Tennessee's TennCare program, the Company also provided managed care and administrative services to TennCare enrollees in Middle Tennessee through April 1, 2007.

In 2006, the State of Tennessee issued a Request for Proposal (RFP) for MCO's for the provision of managed care service for TennCare enrollees and other related populations in Middle Tennessee with the selected MCO's to assume full insurance risk effective April 1, 2007. The Company participated in a joint venture which submitted a proposal that was not selected. Consequently, the Company's active participation in the TennCare program terminated on April 1, 2007.

In September 2006, the Company renewed its contract with CMS to include an expansion of its MA-PD service area and plan offerings effective January 1, 2007. The Company was approved by CMS to expand its service area from seven counties in Tennessee to thirty-one counties in the states of Tennessee, Arkansas, and Mississippi. As part of this expansion, the Company also became licensed as an HMO in the states of Arkansas and Mississippi for the purpose of offering Medicare products.

In September 2006, the Company also contracted with CMS to begin providing prescription drug benefits on a stand-alone basis ("PDP plans") to Medicare eligible beneficiaries in the states of Tennessee, Alabama, Mississippi, and Arkansas, effective January 1, 2007. Additionally, the Company entered into a contract with CMS to begin providing private fee for service ("PFFS") products to Medicare-eligible beneficiaries in the state of Tennessee effective January 1, 2007.

In September 2007, the Company again renewed its contract with CMS to include further expansion of its Medicare service areas and plan offerings effective January 1, 2008. The Company was approved by CMS to expand its MA-PD service area from thirty-one counties in the states of Tennessee, Arkansas, and Mississippi to ninety-six counties in the states of Tennessee, Arkansas, Mississippi, South Carolina and Alabama. It was also approved to expand its PDP service areas to include the state of South Carolina. As part of this expansion, the Company also became licensed as an HMO in the states of Alabama and South Carolina.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation** – The Company prepares its statutory basis financial statements in conformity with accounting practices prescribed or permitted by the Tennessee Department of Commerce and Insurance (the "Department"). The Department requires that insurance companies domiciled in the State of Tennessee prepare their statutory financial statements in accordance with the National Association of Insurance Commissioners' (NAIC) Accounting Practices and Procedures Manual (the "Manual") as modified by the Department.

The preparation of the statutory basis financial statements in accordance with the Manual, as modified, differ in some respects from accounting principles generally accepted in the United States of America (GAAP). Such differences include:

- Certain assets and investments recognized under GAAP are "non-admitted" under statutory accounting practices.
- Income tax effects of differences between tax and book (statutory) accounting are not, in all cases, recognized under statutory accounting practices.
- Administrative fees and related reimbursements under Administrative Services Only arrangements are deducted from general and administrative expenses and reported on a net basis.

Non-admitted assets were $649,344 and $12,500 at December 31, 2007 and 2006, respectively. The changes in non-admitted assets are reflected as a direct charge to capital and surplus. The change in non-admitted assets that was recorded directly to unassigned deficit was $636,844 and $12,500 for the years ended December 31, 2007 and 2006, respectively.

Changes in deferred incomes taxes for the years ended December 31, 2007 and 2006 were $260,594 and $0, respectively and were reflected as a direct charge to capital and surplus.

The statutory-basis statement of admitted assets, liabilities, capital and surplus reflect the operating assets and liabilities of the Company. All amounts in the statements of revenues and expenses have been taken from the separate records or identified costs maintained by the Company and include certain administrative expenses consisting primarily of management fees paid to an affiliated company (see Note 6). These administrative expenses are allocated based on management's estimate of matching such expenses with the benefit received by the Company. The accompanying statutory-basis financial statements have been prepared from the separate records maintained by the Company and may not necessarily be indicative of the conditions that would have existed or the results of operations if the Company had been operated on a stand-alone basis.

**Use of Estimates** – Management of the Company makes estimates and assumptions related to the reporting of admitted assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods to prepare financial statements in conformity with accounting practices prescribed or permitted by the Department. The most significant estimate made by management is medical costs payable. The other significant items subject to estimates and assumptions include CMS risk adjustment receivable and payables to CMS. Actual results could differ from those estimates.

**Cash and Cash Equivalents** – The Company considers all highly liquid instruments with original maturities of three months or less at date of purchase to be cash equivalents.

**Premiums Receivable** – Premiums receivable consists of premiums due from CMS and Medicare enrollees. Management estimates, on an ongoing basis, the amount of member billings that may not be collectible based on a number of factors including a review of past due balances.

**Accounts Receivable From State of Tennessee – net** – Accounts receivable from the State of Tennessee consist of amounts due for administrative service fees and amounts associated with variable administrative fees earned by the Company when certain performance measures are achieved.

**Statutory Requirements** – Certain investments are pledged to the Department in accordance with regulatory requirements. The Company is required by the Department to maintain $2,050,000 and

$4,172,221 in restricted deposits as of December 31, 2007 and 2006, respectively. In addition to the investments pledged to the Department, the Company is also required to pledge similar investments to the regulatory agencies of the other states in which it is licensed. As of December 31, 2007 the collective investments required to be maintained for the states of Arkansas, Mississippi, Alabama and South Carolina totaled $1,105,000. The Company was in compliance with all pledged requirements for both years. Restricted investments are classified as long-term regardless of the contractual maturity date due to the nature of the regulatory requirements.

Additionally, HMO's domiciled in the state of Tennessee must meet certain minimum net worth requirements. The Company's minimum net worth requirements at December 31, 2007 and 2006 were $6,291,309 and $4,172,221, respectively. The Company was in compliance with such requirements for both years.

**Dividend Restrictions** – The maximum amount of dividends that can be paid to shareholders, without the prior approval of the Tennessee Commissioner of Insurance ("Commissioner"), is limited to the greater of 10% of net worth as of December 31 next preceding or the net income from operations (excluding realized capital gains) for the twelve month period ending December 31 next preceding.

In December 2007, the Company provided notification to the Commissioner of its intention to pay a dividend to Windsor in the amount of $1,300,000. This dividend was declared and paid in December 2007.

**Medical Costs Payable** – Medical costs payable represents the liability for services that have been performed by providers for the Company's Medicare members. The liability includes medical and pharmacy claims reported to the plan as well as an actuarially determined estimate of claims that have been incurred but not yet reported ("IBNR"). The IBNR estimates are developed using standard actuarial methods which take into account historical claims payment patterns, industry cost trends, product mix, enrollment levels, seasonality, and health care utilization statistics. These estimates are continually reviewed and adjustments, if necessary, are reflected in the period they become known. Management believes the amount of medical costs payable is reasonable as of December 31, 2007; however, actual claim payments may differ from established estimates.

**Funds Held for the Benefit of Members** – Certain payments from CMS represent prospective payments to fund Part D prescription drug costs for which the Company assumes no financial risk, including catastrophic risk protection and low-income cost sharing subsidies. The Company does not recognize premium revenue or medical costs for these payments as the amounts represent pass-through payments from CMS to fund pharmacy-related deductibles, co-payments and other member expenses. Funds held for the benefit of members represent amounts due to CMS to the extent that such payments from CMS exceed the amount of pharmacy benefits incurred by the plan as of the related balance sheet date. CMS completes an annual reconciliation process to compare payments made to plans verses actual claims incurred and any related payables or receivables are then settled. As of December 31, 2007 and 2006, the Company held amounts for the benefit of members in the amount of $5,259,566 and $5,579,243, respectively. In the third quarter of 2007, CMS recovered $5,444,045 to fully settle all amounts related to the 2006 calendar year.

**Payable to Centers for Medicare and Medicaid Services** – Payable to Centers for Medicare and Medicaid Services includes the Company's estimate of any amounts refundable under the risk sharing provisions of the Company's prescription drug contract with CMS (see below).

**Premium Revenue** – The Company's Medicare contracts with CMS have one year terms coinciding with the calendar year. The Company generally receives premiums in advance of related medical and pharmacy services being performed by plan providers. Premium revenue is recognized during the

period in which the Company is obligated to offer health care benefits to its members. The member portions of the premiums are billed monthly for coverage in the following month and are recognized as revenue in the month for which insurance coverage is provided.

Based on the health conditions of its members, the Company's Medicare premium revenue is subject to adjustment. The process for adjusting premiums is referred to as the CMS risk adjustment payment methodology. The CMS model uses health status indicators referred to as risk scores to improve the correlation of premiums with expected health care costs for Medicare beneficiaries with certain chronic illnesses. Under the risk adjustment payment methodology, managed care plans must capture, document, and report member-specific medical diagnosis code information to CMS by specified due dates. Risk scores are established at the beginning of each calendar year and are then retroactively adjusted on two separate occasions. The first adjustment for a given calendar year generally occurs during the third quarter of such year. It includes a cumulative lump-sum retroactive payment to adjust the first half of the year as well as an update to the members' risk scores for the second half of the year. These adjustments are based on diagnosis information submitted by the Company for eligible claims incurred in the prior year. The second adjustment occurs in the subsequent calendar year, following a CMS reconciliation of all eligible claim information submitted by the Company.

Due to the start of Medicare operations on January 1, 2006, the risk adjustment methodology did not allow for the Company to significantly impact risk scores for the first year nor reasonably estimate potential recoveries related to the risk adjustment process. Accordingly, no amounts receivable were recorded as of December 31, 2006. During the third quarter of 2007 the Company received a payment of $1,275,517 related to 2006 risk adjustment, and recorded the full amount as revenue when it was received. During 2007, the Company began estimating and recording these risk adjustments on a monthly basis, due to the availability of the data as well as improved systems and processes through which to reasonably estimate such amounts. As of December 31, 2007, the Company recorded an estimated CMS risk adjustment receivable of $3,055,461 related to the calendar year 2007. As additional diagnosis code information is reported to and accepted by CMS for a given calendar year, risk adjustment recovery estimates are updated as necessary.

The premium revenue the Company receives monthly from CMS for its Part D prescription drug benefit represents a calculation based on its annual Part D bid amount and the members' related risk scores. However, the amount of Part D revenue paid to a plan by CMS is subject to annual adjustment, either positive or negative, based upon the application of risk corridor calculations that compare a plan's drug costs plus administrative costs targeted in its annual bids ("target amount") to actual prescription drug and administrative costs for the same calendar year. Variances exceeding certain thresholds may result in CMS making additional payments to the Company or the Company being required to refund a portion of the premiums received back to CMS. Actual prescription drug costs subject to risk sharing with CMS are limited to the costs that are, or would have been, incurred under the CMS "defined standard" benefit plan ("allowable risk corridor costs"). Management has estimated and recognized an adjustment to premium revenues related to the risk corridor payment adjustment based upon pharmacy claims experience to date as if the annual contract were to terminate at the end of the reporting period. At December 31, 2007 and 2006, the risk corridor payable to CMS was $948,440 and $1,020,757, respectively. During 2007, the CMS recovered $614,396 as settlement for the 2006 calendar year. The 2007 settlement is expected to occur in the third quarter of 2008.

**Administrative Services Revenue** – Under the TennCare agreement, TennCare reimbursed the Company for all medical costs incurred. In accordance with statutory guidelines, this reimbursement is netted against the medical costs recognized. In addition to the reimbursement of medical costs, the TennCare program provided the Company with a fixed administrative fee based on the average per capita base for the entire TennCare population. The Company also achieved certain performance measures as outlined within its contract with the Bureau of TennCare and recognized variable

administrative service fees and other incentive-based revenue of $400,000 and $785,475 for the years ended December 31, 2007 and 2006, respectively.

**Excess Loss Insurance** – The Company purchased excess loss insurance coverage from a third party to limit the loss on individual inpatient hospital claims. This insurance provides coverage for aggregate claims per enrollee per year in excess of $150,000 (subject to certain per day limits). Premiums paid and recoveries received and/or accrued are accounted for consistently with the terms of the excess loss insurance contract. Excess loss insurance recoveries were $461,000 and $60,000 for the years ended December 31, 2007 and 2006, respectively.

**Federal Income Taxes** – Windsor files a consolidated federal tax return which includes the operations of the Company and Windsor Management Services, Inc. ("WMS") as well as other Windsor subsidiaries. The Company computes its federal tax provision as though it files a separate return and periodically remits payments to Windsor for the estimated liability. In accordance with statutory accounting practices, deferred federal income taxes are provided for the tax effects of temporary differences between the carrying values and tax bases of assets and liabilities.

**Concentration of Business and Credit Risks** – The Company, as well as the healthcare industry overall, is significantly impacted by federal government regulations as well as general healthcare cost trends. These factors may significantly affect the Company's overall performance through changes to premium rates and/or medical cost reimbursement rates, which in turn impact management's estimates of medical claim liabilities.

Substantially all of the Company's premium revenue for 2007 and 2006 was derived from contracts with CMS, which are renewable annually and are terminable by CMS in the event of material breach or violation of relevant laws or regulations. In addition, substantially all of the Company's membership in its stand-alone PDP results from automatic enrollment by CMS of members in CMS regions where the Company's Part D premium bid is below the relevant benchmark. If future Part D bids are not below the benchmark, CMS may not assign additional PDP members to the Company and may reassign PDP members previously assigned to the Company.

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of investment securities and receivables generated in the ordinary course of business. Investment securities are managed by professional investment managers within guidelines established by the Company and applicable regulatory agencies. Due to strict regulatory guidelines, investments are generally held in highly rated government-backed securities or highly liquid money market accounts. The Company had no significant concentrations of credit risk at December 31, 2007 or 2006.

**Statement of Statutory Accounting Principles No. 96** – *Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No. 25 – Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* – This statement establishes a statutory aging threshold for admission of loans and advances to related parties outstanding as of the reporting date. In addition, this statement establishes an aging threshold for admission of receivables associated with transactions for services provided to related parties outstanding as of the reporting date. This statement is effective for reporting periods ending December 31, 2007 and thereafter. The adoption of this interpretation did not materially impact the Company's financial position or results of operations.

## 3. RESTRICTED INVESTMENTS

Restricted investment securities consist of held-to-maturity debt securities with maturities ranging from one to five years. The amortized cost, gross unrealized gains, gross unrealized losses and estimated fair value of held-to-maturity securities at December 31, 2007 and 2006, are as follows:

| | 2007 | | | |
|---|---|---|---|---|
| Bonds | Amortized Cost | Unrealized Gain | Unrealized Loss | Estimated Fair Value |
| U.S. Treasury Notes | $ 300,074 | $ 166 | $ - | $ 300,240 |
| Mortgage-backed securities | 5,529,163 | 51,594 | - | 5,580,757 |
| Total | $ 5,829,237 | $ 51,760 | $ - | $ 5,880,997 |

| | 2006 | | | |
|---|---|---|---|---|
| Bonds | Amortized Cost | Unrealized Gain | Unrealized Loss | Estimated Fair Value |
| U.S. Treasury Notes | $ 300,962 | $ 679 | $ - | $ 301,641 |
| Mortgage-backed securities | 4,745,525 | - | 21,295 | 4,724,230 |
| Total | $ 5,046,487 | $ 679 | $ 21,295 | $ 5,025,871 |

At December 31, 2007 and 2006, bonds totaling $5,829,237 and $5,046,487, respectively, were pledged to state insurance regulators in accordance with each state's regulatory requirements. The Company has the intent and ability to hold these investments until their maturity date.

The scheduled maturities of held-to-maturity debt securities are as follows:

| | |
|---|---|
| Due in one year or less | $2,540,090 |
| Due one year through five years | 3,289,147 |
| | $5,829,237 |

## 4. MEDICAL COSTS PAYABLE

Medical costs payable includes amounts for medical and pharmacy costs payable and the reserve for incurred but not reported medical claims. Information regarding medical costs payable as of December 31, 2007 and 2006 is as follows:

| | 2007 | 2006 |
|---|---|---|
| Beginning of year | $ 8,958,606 | $ - |
| Incurred related to: | | |
| Prior years | (1,681,260) | (5,009) |
| Current year | 95,819,036 | 45,661,004 |
| Total incurred | 94,137,776 | 45,655,995 |
| Paid related to: | | |
| Prior years | 7,134,495 | 5,009 |
| Current year | 80,833,322 | 36,692,380 |
| Total paid | 87,967,817 | 36,697,389 |
| End of year | $ 15,128,565 | $ 8,958,606 |

## 5. FEDERAL INCOME TAXES

The Company is included in the consolidated federal tax return of Windsor. The Company computes its federal income tax provision as if it files a separate return. The federal income tax provision is $1,596,037 and $0, respectively for the years ended December 31, 2007 and 2006. A written tax sharing agreement has not been executed to date.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. At December 31, 2007 and 2006, total deferred tax assets were $260,594 and $0, respectively. The Company's net deferred tax asset represents the tax effect of temporary differences relating to loss reserves of $179,785, amortization of premiums of $14,529 and accrued expenses of $66,281.

## 6. RELATED-PARTY TRANSACTIONS

*Sale of Company Stock to Windsor Health Group, Inc.* – In March 2001, the Department approved the sale of 100% of the Company's stock held by Vanderbilt Health Services, Inc. ("VHS") to Windsor effective August 31, 2000. The consideration included a surplus note issued by the Company to VHS for a principal amount of $4,231,300.

The surplus note payable requires quarterly payments of interest at prime subject to approval of the Commissioner, with the principal balance due on March 29, 2012. The Company paid interest of $50,109 and $0 during 2007 and 2006, respectively. At December 31, 2007 and 2006, $1,413,718 and $1,130,748, respectively, is payable on the surplus note representing accrued interest; however, since payment of this amount has not been approved by the Commissioner, the related expense and payable have not been recorded in the Company's statutory basis financial statements. At December 31, 2007, the Company has paid a total of $285,700 in interest since the inception of the surplus note.

In March 2008, the Company amended the surplus note payable. The maturity date was extended to March 29, 2012 and the interest rate increased to prime plus 2%. In February 2008 the Company also received approval from the Commissioner to pay $1,253,740 of accrued interest associated with the surplus note for the periods of July 2002 through June 2007.

In the event of reorganization, dissolution, liquidation, receivership, insolvency or bankruptcy of the Company, the claims of the holder of the surplus note shall be subordinated to policyholder, claimant and beneficiary claims as well as debts owed to all other classes of creditors other than the holder. The claims of the holder of the surplus note shall be superior to claims of the Company's common shareholders.

*Medical Costs* – For the years ended December 31, 2007 and 2006, medical costs included $5,831,180 and $9,578,987, respectively, paid or due to entities owned by or affiliated with Vanderbilt University. For the years ended December 31, 2007 and 2006, medical costs included $8,286,839 and $9,012,872, respectively, paid to Windsor HomeCare Network, LLC, an affiliate of the Company.

*Administrative Expenses* – The Company pays a monthly management fee to WMS for administrative services based on a percentage of premium revenue (implied TennCare premium revenue through March 31, 2007 and actual Medicare premium revenue beginning January 1, 2006) as specified in management agreements between the two parties. In 2006, the WMS Board of Directors elected to forgive $3,205,566 of the monthly management fee related to the TennCare line of business. Accordingly, the resulting management fees related to this line of business were effectively equal to the actual monthly administrative revenue for that year. For the year ended December 31, 2007, the WMS Board of Directors did not forgive any portion of the monthly management fees. Management fee expense was $23,656,780 and $17,481,023 in 2007 and 2006, respectively. The Company had an amount receivable related to an overpayment of management fees of $901,867 at December 31, 2007 and an amount payable related to unpaid management fees of $938,492 at December 31, 2006.

For the years ended December 31, 2007 and 2006, the Company paid $101,315 and $0, respectively to Vanderbilt University Medical Center for administrative costs associated with the Company's review of medical charts for the purpose of collecting diagnosis information related to the risk adjustment process.

*Windsor Health Group, Inc. Credit Facility* – In March 2008, Windsor entered into a credit facility with a financial institution for $7,500,000 with a maturity date of March 13, 2010. The Company's stock was pledged as collateral under the terms of the credit facility.

## 7. ADMINISTRATIVE SERVICES REVENUE AND EXPENSES

The net of administrative services fee revenue and administrative expenses include management fees paid to WMS (see Note 6). The Company has allocated the management fees to the following categories based on the ratio of actual expenses incurred by WMS.

| | 2007 | 2006 |
|---|---|---|
| Salaries and benefits | $ 1,865,130 | $ 3,682,684 |
| Outsourced services, including claims, actuarial, and other services | 545,027 | 1,584,493 |
| Rent and occupancy | 97,421 | 190,965 |
| Other | 1,648,130 | 3,101,469 |
| Administrative services fee revenue | (2,042,587) | (7,260,230) |
| | $ 2,113,121 | $ 1,299,381 |

Under the terms of the TennCare agreement, the Company had an Administrative Services Only (ASO) arrangement, for which the TennCare Program retained all financial risk for health care services, while the Company retained the financial risk for administrative costs. The Company recorded administrative service fee revenues of $2,042,587 and $7,260,230 in 2007 and 2006, respectively. Administrative expenses are shown net of these amounts in the accompanying statutory statements of revenue and expenses for the years ended December 31, 2007 and 2006.

The gain from operations from the ASO uninsured plan was as follows during 2007 and 2006:

| | 2007 | 2006 |
|---|---|---|
| Deficiency of net reimbursement for administrative expenses over actual expenses | $ (2,113,121) | (1,299,381) |
| Net loss from operations | $ (2,113,121) | $ (1,299,381) |
| Total claim payment volume | $35,207,450 | $95,104,700 |

## 8. PHARMACY REBATES

Pharmaceutical rebates represent estimated rebates owed to the Company based on the utilization of eligible prescription drugs by the Company's members at participating pharmacies. The Company's contracted pharmacy benefits manager ("PBM") holds the contracts with the pharmaceutical manufacturers and accordingly, oversees and manages the administration of such rebates. Each quarter, the Company receives detailed pharmacy rebate reports from the PBM that lists rebates receivable by manufacturer. The Company reviews these reports and uses the information to estimate the related receivables. Rebates are recognized when earned according to the contractual arrangements with the respective pharmaceutical manufacturers. Pharmaceutical rebates receivable was $1,117,063 and $426,890 at December 31, 2007 and 2006, respectively, of which $615,188 and $0 were non-admitted assets at these dates. Pharmaceutical rebates receivable, to the extent admitted, are included within other receivables on the accompanying statements of admitted assets, liabilities, capital and surplus – statutory basis. Information regarding pharmaceutical rebates for 2007 and 2006 is as follows:

| For the Quarter Ended | Estimated Pharmacy Rebates Receivable | Pharmacy Rebates as Invoiced or Otherwise Confirmed | Pharmacy Rebates Collected |
|---|---|---|---|
| 12/31/2007 | 625,000 | 501,875 | - |
| 9/30/2007 | 180,000 | 464,618 | - |
| 6/30/2007 | 280,000 | 407,355 | 336,541 |
| 3/31/2007 | 180,000 | 358,642 | 287,662 |
| 12/31/2006 | 130,000 | 145,920 | 156,261 |
| 9/30/2006 | 200,511 | 159,176 | 147,526 |
| 6/30/2006 | 76,498 | 104,204 | 118,595 |
| 3/31/2006 | 48,000 | 67,624 | 49,162 |

## SUPPLEMENTAL AND ADDITIONAL INFORMATION

## WINDSOR HEALTH PLAN, INC.

### SUPPLEMENTAL SCHEDULE OF INVESTMENT RISK INTERROGATORIES — STATUTORY BASIS
### DECEMBER 31, 2007

The Company's total admitted assets as reported in the statement of admitted assets, liabilities, capital and surplus was $30,257,235 at December 31, 2007.

1. The 10 largest exposures to a single issuer/borrower/investment, by investment category, excluding: (i) U.S. government, U.S. government agency securities and those U.S. government money market funds listed in the Appendix to the *SVO Purposes and Procedures Manual* as exempt, (ii) property occupied by the Company, and (iii) policy loans at December 31, 2007 are as follows:

| Investment Category | Amount | Percentage of Total Admitted Assets |
|---|---|---|
| Investment/Checking Account — Bank of America | $ 8,047,788 | 26.6 % |
| Investment/Checking Account — Fifth Third | $ 11,724,813 | 38.8 % |
| Investment/Checking Account — Regions | $ 140,923 | 0.5 % |

2. The amounts and percentages of the Company's total admitted assets held in bonds and preferred stocks, by NAIC rating, are as follows:

| | Amount | Percentage of Total Admitted Assets |
|---|---|---|
| **Bonds** | | |
| NAIC — 1 | $ 5,829,237 | 19.3 % |

## WINDSOR HEALTH PLAN, INC.

### SUPPLEMENTAL SUMMARY OF INVESTMENT SCHEDULE — STATUTORY BASIS
### DECEMBER 31, 2007

| | Gross Investment Holdings* | Admitted Assets as Reported in the Annual Statement |
|---|---|---|
| **Investment Categories** | | |
| Bonds: | | |
| Mortgage-backed securities (includes residential and commercial MBS): | | |
| Pass-through securities: | | |
| Issued by FNMA and FHLMC | $ 5,529,163 | $ 5,529,163 |
| U.S. Treasury Notes | $ 300,074 | $ 300,074 |

*** Gross Investment Holdings as valued in compliance with the Manual, as modified**

## WINDSOR HEALTH PLAN, INC.

### ADDITIONAL INFORMATION — SUMMARIZED SCHEDULE OF REVENUES AND EXPENSES — STATUTORY BASIS OF WINDSOR HEALTH PLAN, INC. TENNCARE OPERATIONS YEARS ENDED DECEMBER 31, 2007 AND 2006

| | 2007 | 2006 |
|---|---|---|
| REVENUES: | | |
| Recovery of medical expenses | $ 10,764 | $ 5,009 |
| Investment income — net | 213,911 | 187,259 |
| Total revenues | 224,675 | 192,268 |
| EXPENSES: | | |
| Administrative service expenses, net | 2,113,121 | 1,234,440 |
| Total expenses | 2,113,121 | 1,234,440 |
| DEFICIENCY OF REVENUES OVER EXPENSES | $(1,888,446) | $(1,042,172) |

# INDEX TO HEALTH ANNUAL STATEMENT

# INDEX TO HEALTH ANNUAL STATEMENT